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No. 03-1304

Supreme Court, U.S.
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In The

Supreme Court of the United States

DORIS STIEGLITZ WARD, individually and on behalf of all others similarly situated,

Petitioners,

v.

STATE OF SOUTH CAROLINA,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of South Carolina

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Did the South Carolina Supreme Court properly hold that Act No. 189 of 1989, which resulted in the imposition of the same taxation on federal and state retirement benefits, is consistent with the intergovernmental tax immunity doctrine, as interpreted in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989)?

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
TABLE OF AUTHORITIES	iii
INTRODUCTION	1
STATEMENT OF THE CASE	3
REASONS FOR DENYING THE PETITION	5
I. THE SOUTH CAROLINA SUPREME COURT'S DECISION CONFORMS TO THE MANDATE OF *DAVIS V. MICHIGAN*	5
A. 4 U.S.C. § 111 and *Davis v. Michigan*	7
B. South Carolina's Response to *Davis v. Michigan*	9
C. Consistency of the South Carolina Supreme Court's Decision with *Davis v. Michigan*	10
II. NO TRUE CONFLICT EXISTS AMONG STATE COURTS CONSIDERING LEGISLATIVE RESPONSES TO *DAVIS V. MICHIGAN*	20
III. THE NATIONAL SIGNIFICANCE OF THE CURRENT CASE IS LIMITED	25
CONCLUSION	26

TABLE OF AUTHORITIES

Page

CASES

Almeter v. Virginia Dep't of Taxation, 2000 WL 1687589 (Va. Cir. Ct. 2000) 6, 16, 20-22, 25

Almeter v. Virginia Dep't of Taxation, 534 U.S. 889 (2001) 6

Bank of California v. Oregon Dep't of Revenue, 516 U.S. 1011 (1995) 6

Davis v. Michigan Dep't of Treasury, 489 U.S. 803 (1989) ..... *passim*

Harper v. Virginia Dep't of Taxation, 509 U.S. 86 (1993) 6, 8, 13

Hernandez v. New York, 500 U.S. 352 (1991) (plurality opinion) 18

New York v. United States, 505 U.S. 144 (1992) 11

Ragsdale v. Department of Revenue, 895 P.2d 1348 (Or. 1995) 5, 11-12, 20-22, 25

Reich v. Collins, 513 U.S. 106 (1994) 6

Sheehy v. Public Employees Retirement Division, 864 P.2d 762 (Mont. 1993) 20, 21, 22, 24, 25

Vogl v. Department of Revenue, 960 P.2d 373 (Or. 1998) 20, 21-25

Ward v. State, 538 S.E.2d 245 (S.C. 2000) 4

Ward v. State, 590 S.E.2d 30 (S.C. 2003) ..... *passim*

West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994) 19

TABLE OF AUTHORITIES – Continued

Page

STATUTES

4 U.S.C. § 111 ..... *passim*

Act No. 189, 1989 S.C. Acts, Part II, §§ 39, 60(B)-(G) ..... *passim*

S.C. Code Ann. §§ 9-1-1550(A)(3) & (B), 9-1-1767, 9-8-60(2), 9-11-60(2), and 9-11-300 (Supp. 2003) 1

S.C. Code Ann. § 12-6-510 & 12-6-1170 (Supp. 2003)..... 18

S.C. Code Ann. § 12-60-10 *et seq.* (Cum. Supp. 1998)..... 4

S.C. Code Ann. § 15-3-530 (Supp. 2003) 1

RULES

Sup. Ct. R. 10..... 18

OTHER SOURCES

22 James Wm. Moore, *Moore's Federal Practice* § 406.05[4] (3d ed. 2002)..... 18

Almeter v. Virginia Department of Taxation, 2000 WL 1687589 (Va. Cir. Ct. 2000), *petition denied*, (Va. 2001), *petition for cert.*, 2001 WL 34115936 (U.S. July 12, 2001) (No. 01-74) 6

Ragsdale v. Dep't of Revenue, 895 P.2d 1348 (1995), *petition for cert. sub nom, Bank of California v. Oregon Dep't of Revenue*, 1995 WL 17035874 at *5 (U.S. Oct. 10, 1995) (No. 95-592)..... 6

INTRODUCTION

This case is an outgrowth of the decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). *Davis* held that the doctrine of intergovernmental tax immunity, codified at 4 U.S.C. § 111, prohibits states from taxing income derived from federal retirement at a greater rate than income derived from state retirement. *See Davis*, 489 U.S. at 817. Under *Davis*, states could eliminate the discriminatory treatment either by taxing federal and state retirement income or by taxing neither. *Id.* at 817-18.

Prior to 1989, South Carolina exempted from taxation the first $3,000 of federal retirement income, but exempted from taxation all state retirement income. In 1989, South Carolina responded to the mandate of *Davis* by passage of Act No. 189, 1989 S.C. Acts, Part II, §§ 39, 60(B)-(G) ("Act 189").[1] Act 189 eliminated the tax exemption for state retirees. The Act also increased state retirees' retirement compensation by 7%. Nearly a decade after the passage of Act 189,[2] federal retirees ("Petitioners") initiated the current action contending that Act 189 violated the intergovernmental tax immunity doctrine. The trial court and the South Carolina Supreme Court rejected Petitioners' contention. Petitioners are now seeking review of the state supreme court's decision. For the reasons set forth below, the petition for writ of certiorari should be denied as the South Carolina Supreme Court's decision is

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[1] Codified, *inter alia*, at S.C. Code Ann. §§ 9-1-1550(A)(3) and (B), 9-1-1767, 9-8-60(2), 9-11-60(2), and 9-11-300 (Supp. 2003).

[2] *Cf.* S.C. Code Ann. § 15-3-530 (Supp. 2003) (setting forth three year statute of limitations for "an action upon a liability created by statute").

consistent with the intergovernmental tax immunity doctrine and *Davis*:

1. *Davis* required that states that had differentially taxed federal and state retirees cure the difference "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Through passage of Act 189, South Carolina chose the latter option presented by *Davis*. Petitioners are mistakenly attempting to write into the *Davis* decision the additional condition that if a state eliminates the tax exemption for state and local government employees, the state cannot also increase the retirement benefits of its own retirees. *Davis* did not set forth such a limitation. Further, such a limitation on a state's ability to alter its retirement benefits would be inconsistent with the Tenth Amendment.

2. The South Carolina Supreme Court's decision comports with *Davis* because the intergovernmental tax immunity doctrine, as codified in 4 U.S.C. § 111, is concerned with taxation and not compensation.

3. The South Carolina Supreme Court's proper application of the holding of *Davis* is indisputably confirmed by the fact that Petitioners would have paid exactly the same amount in state income taxes had state retirees not received a retirement benefits increase under Act 189. If South Carolina had taken the "constitutional" approach implied by Petitioners, by just eliminating the tax exemption for state retirees but not increasing state retirement benefits, Petitioners' state income taxes would have been precisely the same as they are under Act 189.

4. *Davis* impliedly recognized that states may increase salaries or benefits of their employees, as long as they do not do so "at the expense of the federal treasury." *Davis*, 489 U.S. at 815 n.4. By increasing the retirement benefits of its employees, South Carolina has bolstered, rather than weakened, the federal treasury.

5. The absence of a direct correlation between the amount of the retirement benefits increase under Act 189 and state retirees' new state tax obligations undermines the factual basis of Petitioners' argument that the benefits increase is simply a "tax rebate."

6. There does not exist a true conflict among the few state court decisions that have considered the issue in this case. Analysis of the relevant cases reveals that factually distinct legislative schemes have led to different conclusions by state courts considering the constitutionality of those schemes.

7. A decision by the Court in this case would have limited precedential value because there are only two other jurisdictions that could potentially directly be impacted by this case.

STATEMENT OF THE CASE

Petitioner Doris Stieglitz Ward, a federal retiree, commenced this suit on November 5, 1998 against Respondent State of South Carolina, purporting to bring this action not only on her own behalf but also on behalf of all other federal retirees – Petitioners. In their complaint, Petitioners alleged that South Carolina's Act 189 violated the constitutional doctrine of intergovernmental tax

immunity, infringed their federal and state constitutional rights to equal protection, and also constituted a taking of their property without just compensation.

In September 1999, the state trial court dismissed this action on the ground that the remedies provided by the South Carolina Revenue Procedures Act, S.C. Code Ann. § 12-60-10 *et seq.* (Cum. Supp. 1998), were exclusive, and Petitioners were required to follow those administrative procedures before seeking judicial review of their claims. Petitioners appealed the ruling to the South Carolina Supreme Court. The state supreme court reversed the trial court's order, finding that Petitioners were not required to exhaust their administrative remedies under the South Carolina Revenue Procedures Act because that "statute does not apply in cases where the sole issue is whether a statute or other legislative action is constitutional." *Ward v. State*, 538 S.E.2d 245, 248 (S.C. 2000).

Upon remand, Petitioners moved to certify a class. The trial court granted the motion. Subsequently, the parties filed cross-motions for summary judgment. After responsive briefs were filed, the trial court conducted oral argument on the motions, and on August 26, 2002, issued an order granting South Carolina's motion for summary judgment and denying Petitioners' motion for partial summary judgment. (Petition for a Writ of Certiorari, Appendix C).

Petitioners appealed the trial court's order. On appeal before the South Carolina Supreme Court, Petitioners abandoned their equal protection and takings claims and argued solely that Act 189 violated the intergovernmental tax immunity doctrine. The state supreme court rejected Petitioners' argument, holding that Act 189 was consistent

with the intergovernmental tax immunity doctrine, as interpreted by this Court in *Davis*, 489 U.S. 803. *Ward v. State*, 590 S.E.2d 30 (S.C. 2003). Petitioners are now seeking from this Court a writ of certiorari to the South Carolina Supreme Court.

REASONS FOR DENYING THE PETITION

I. THE SOUTH CAROLINA SUPREME COURT'S DECISION CONFORMS TO THE MANDATE OF *DAVIS V. MICHIGAN*.

The Court should deny the petition for writ of certiorari because the decision of the South Carolina Supreme Court in the present action is consistent with this Court's ruling in *Davis*, 489 U.S. 803. As detailed below, the state supreme court correctly concluded that Act 189, which resulted in the imposition of the same taxation on federal and state retirement benefits, does not violate the intergovernmental tax immunity doctrine, codified in 4 U.S.C. § 111.[3]

[3] While the denial of certiorari lacks precedential value, it is of interest that this Court has on two prior occasions denied certiorari on precisely the same issue presented in this case. After the Oregon Supreme Court held that that state's legislative response to *Davis v. Michigan* did not violate the intergovernmental tax immunity doctrine, *see Ragsdale v. Department of Revenue*, 895 P.2d 1348 (Or. 1995), the taxpayer petitioned this Court for writ of certiorari, raising the following issue:

> The question presented is whether a state may lawfully defeat a constitutional mandate of the Supreme Court of the United States by enacting a sham statute that purports to tax state and federal government pensions equally, but that,

(Continued on following page)

> at the same time, rebates the state tax to state government retirees in the form of an increased pension, thus attempting to avoid the federal requirement of equality of taxation of state and federal retirees in 4 USC 111 and as pronounced by this Court in *Reich v. Collins*, 513 U.S. 106, 130 L.Ed.2d 454, 115 S.Ct. 547 (1994); *Harper v. Virginia Department of Taxation*, 509 U.S. 86, 125 L.Ed.2d 74, 113 S.Ct. 2510 (1993); and *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 103 L.Ed.2d 891, 109 S.Ct. 1500 (1989).

Ragsdale v. Dep't of Revenue, 895 P.2d 1348 (1995), *petition for cert. sub nom*, *Bank of California v. Oregon Dep't of Revenue*, 1995 WL 17035874 at *5 (U.S. Oct. 10, 1995) (No. 95-592). This Court denied the petition for certiorari. *Bank of California v. Oregon Dep't of Revenue*, 516 U.S. 1011 (1995).

More recently, this Court considered a similar petition in *Almeter v. Virginia Department of Taxation*, 2000 WL 1687589 (Va. Cir. Ct. 2000), *petition denied*, (Va. 2001), *petition for cert.*, 2001 WL 34115936 (U.S. July 12, 2001) (No. 01-74). In *Almeter*, federal retirees in Virginia petitioned this Court, seeking review of a lower court decision that had rebuffed a constitutional attack on the legitimacy of Virginia's legislative response to *Davis v. Michigan*. The issue raised before this Court was:

> Whether it is constitutionally valid under *Davis* [*v. Michigan*] for Virginia to discriminate against Federal retirees by imposing a heavier tax burden on Federal retirement benefits than on State and local retirement benefits through tax rebates to State and local retirees.

Almeter, 2001 WL 34115936 at *ii. Again, this Court denied the petition for writ of certiorari. *Almeter v. Virginia Dep't of Taxation*, 534 U.S. 889 (2001).

While this Court's denials of the petitions in *Ragsdale* and *Almeter* do not have any binding effect on whether the current petition should be granted, it is noteworthy that the legal landscape has not changed since this Court's consideration of these petitions. For the substantive reasons discussed herein, the Court should also deny certiorari in the present action.

A. 4 U.S.C. § 111 and *Davis v. Michigan*

The Public Salary Tax Act, 4 U.S.C. § 111, provides in relevant part:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States, a territory or possession or political subdivision thereof, the government of the District of Columbia, or an agency or instrumentality of one or more of the foregoing, by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

As interpreted in *Davis*,

> [4 U.S.C.] Section 111 was enacted as part of the Public Salary Tax Act of 1939, the primary purpose of which was to impose federal income tax on the salaries of all state and local government employees. Prior to the adoption of the Act, salaries of most government employees, both state and federal, generally were thought to be exempt from taxation by another sovereign under the doctrine of intergovernmental tax immunity.

Davis, 489 U.S. at 810. Concerned that considerations of fairness demanded

> equal tax treatment for state and federal employees, Congress decided to ensure that federal employees would not remain immune from state taxation at the same time that state government employees were being required to pay federal income taxes. Accordingly, § 4 of the proposed Act (now § 111) expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state taxes.

. . .

> Section 111 did not waive all aspects of intergovernmental tax immunity, however. The final clause of the section contains an exception for state taxes that discriminate against federal employees on the basis of the source of their compensation. This nondiscrimination clause closely parallels the nondiscrimination component of the constitutional immunity doctrine which has, from the time of *McCulloch v. Maryland*, barred taxes that "operat[e] so as to discriminate against the Government or those with whom it deals."

Davis, 489 U.S. at 812 (internal citations omitted).[4]

Applying these principles, the *Davis* Court struck down a Michigan statute, finding it violative of 4 U.S.C. § 111. Prior to *Davis*, Michigan, like 22 other states including South Carolina, gave preferential treatment to state and local government employees, in comparison to federal employees, on the taxation of their benefits. *See Harper v. Virginia Dep't of Taxation*, 509 U.S. 86, 93 (1993). *Davis* held that the doctrine of intergovernmental tax immunity prohibits the states from taxing federal government retirees at a greater rate than state and local government retirees are taxed. *Davis*, 489 U.S. at 817. Disparate taxation of federal and state retirement income would be

[4] The Court further explained that "the retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity." *Davis*, 489 U.S. at 813.

inconsistent with 4 U.S.C. § 111's requirement that taxation "not discriminate . . . because of the source of the pay or compensation." *See* 4 U.S.C. § 111(a).

Davis declared that the appropriate remedy for Michigan's violation of the intergovernmental tax immunity doctrine and 4 U.S.C. § 111 was a mandate of "equal treatment, a result that can be accomplished by withdrawal of benefits from the favored class as well as by extension of benefits to the excluded class." *Davis*, 489 U.S. at 817-18 (internal quotations omitted). The Court specified that

> appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. . . . [T]he Michigan courts are in the best position to determine how to comply with the mandate of equal treatment.

Davis, 489 U.S. at 818.

B. South Carolina's Response to *Davis v. Michigan*

As noted earlier, prior to *Davis*, South Carolina gave preferential tax treatment to state and local government retirees: State retirement benefits were fully exempt from taxation in South Carolina, while only the first $3,000 of federal retirement benefits were tax-exempt. *Ward*, 590 S.E.2d at 32. In light of *Davis*'s guidance that states could cure the differential treatment "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees," *Davis*, 489

U.S. at 818, South Carolina chose the latter approach. In 1989, the State's legislature passed Act 189, which repealed the full tax exemption on state retirement benefits, thereby rendering taxable all federal and state retirement benefits in excess of $3,000. *See Ward*, 590 S.E.2d at 32 (citing Act 189, § 39). In addition to repealing the tax exemption, the General Assembly increased the retirement benefits for state and local government retirees by 7%. *Id.* (citing Act 189, § 60).

Nearly a decade after the passage of Act 189, Petitioners initiated the current action contending that South Carolina's Act 189 violated the intergovernmental tax immunity doctrine, as interpreted in *Davis*. Although Petitioners, as federal retirees, are taxed precisely the same as state retirees, Petitioners nevertheless contend that Act 189 violates 4 U.S.C. § 111 because, in addition to having eliminated the tax exemption for state retirees, the Act provided a benefits increase to state retirees. The South Carolina Supreme Court found Petitioners' argument to be without merit. For the reasons discussed below, the state supreme court's decision comports with the guidance of this Court in *Davis*, so the petition for writ of certiorari should be denied.

C. Consistency of the South Carolina Supreme Court's Decision with *Davis v. Michigan*

This Court should decline to grant certiorari because the decision of the South Carolina Supreme Court is consistent with the mandate of *Davis*, 489 U.S. 803, as confirmed by the following five reasons.

First, *Davis* provided states with two options for eliminating discriminatory taxation of federal and state

retirement benefits. A state could tax federal and state retirees alike, or it could tax neither. *Davis*, 489 U.S. at 818. South Carolina chose to tax federal and state retirees alike by eliminating the full tax exemption that was previously applicable only to state retirees. In this case, Petitioners are attempting to write into *Davis* the additional condition that a state is prohibited from increasing the retirement benefits of its own retirees at the same time that it chooses to tax equally state and federal retirees. Such a condition does not appear in *Davis*. *See Ward*, 590 S.E.2d at 32 ("[T]he doctrine of intergovernmental tax immunity does not deprive a state of its sovereignty to establish the level of its employees' compensation as long as the State does not discriminate in taxation based on the source of the income."); *Ragsdale*, 895 P.2d at 1353 n.11 ("*Davis* does not hold or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired. . . . What is prohibited by *Davis* is taxation discrimination 'on account of the source of the compensation' that is not 'directly related to, and justified by, 'significant differences between the two classes.'") (quoting *Davis*).

A limitation on a state's ability to alter its retirement benefits would be incompatible with the Tenth Amendment to the United States Constitution. *See New York v. United States*, 505 U.S. 144, 156 (1992) ("If a power is delegated to Congress in the Constitution, the Tenth Amendment expressly disclaims any reservation of that power to the States; if a power is an attribute of state sovereignty reserved by the Tenth Amendment, it is necessarily a power the Constitution has not conferred on Congress."). The power to compensate state employees and retirees is obviously not a power the Constitution has

conferred on Congress; therefore, it is a power reserved to the States by the Tenth Amendment. Accordingly, as long as federal and state retirees are taxed in the same manner, there is nothing preventing a state from increasing the benefits of its own retirees. *See Ward*, 590 S.E.2d at 32 ("As long as federal and state retirees are taxed equally, any restriction on this authority would violate the Tenth Amendment."); *Ragsdale*, 895 P.2d at 1357 ("The state should be free to compensate its employees with its eyes open to the tax burdens that it places on them. We do not believe that the Supreme Court of the United States would assert that the principle of intergovernmental tax immunity deprives the state of its sovereignty to fix the level of its employees' compensation. . . . ").[5]

Second, the state supreme court's decision is consistent with *Davis* because the intergovernmental tax immunity doctrine, as codified in 4 U.S.C. § 111, is concerned with taxation and not compensation. The statute provides in relevant part: "The United States consents to the *taxation* of pay or compensation for personal service as an

[5] Petitioners have previously argued that states are free to raise the benefits of their retirees as long as such increases do not coincide with the elimination of a tax exemption. There is simply no support for such an argument. If the South Carolina General Assembly had raised the retirement benefits of state retirees one year, one month, or one week after eliminating state retirees' tax exemption, there would have been no constitutional violation under Petitioners' theory. However, Petitioners have posited that because the increase occurred at the same time as the elimination of the tax exemption, there is a constitutional violation. Petitioners have yet to articulate a single persuasive reason why a state (or even the federal government) is constitutionally prohibited from raising the benefits of its retirees at any time, including at the same time as eliminating a tax exemption.

officer or employee of the United States . . . if the *taxation* does not discriminate against the officer or employee because of the source of the pay or compensation." 4 U.S.C. § 111(a) (emphasis added). *Davis* confirms that 4 U.S.C. § 111 is concerned with the equality of treatment in the *taxation* of federal and state retirees.[6] Neither 4 U.S.C. § 111 nor *Davis* concerns itself with the compensation that states pay their employees or retirees. By contrast, Petitioners argue, in effect, that *Davis* mandates equality not only of taxation, but also of take-home income. Thus, despite the fact that federal and state retirees in South Carolina pay taxes at precisely the same rates and with the same exemptions, Petitioners still insist that there is inequality of treatment because the take-home income of

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[6] *See Davis*, 489 U.S. at 810 ("[4 U.S.C. § 111] waives whatever immunity past and present federal employees would otherwise enjoy from state *taxation* of salaries, retirement benefits, and other forms of compensation . . . except to the extent that such *taxation* discriminates on account of the source of the compensation.") (emphasis added); *id.* at 812 ("[C]onsiderations of fairness demanded equal *tax* treatment for state and federal employees. . . . ") (emphasis added); *id.* ("[4 U.S.C. § 111] expressly waived whatever immunity would have otherwise shielded federal employees from nondiscriminatory state *taxes*.") (emphasis added); *id.* ("The final clause of the section [4 U.S.C. § 111] contains an exception for state *taxes* that discriminate against federal employees on the basis of the source of their compensation.") (emphasis added); *id.* at 818 ("[A]ppellant's claim could be resolved either by extending the *tax* exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees.") (emphasis added).

Subsequent interpretation of *Davis* by this Court has also focused on taxation: "In *Davis* . . . , we held that a State violates the constitutional doctrine of intergovernmental tax immunity when it *taxes* retirement benefits paid by the Federal Government but exempts from *taxation* all retirement benefits paid by the State or its political subdivisions." *Harper*, 509 U.S. at 89 (emphasis added).

state retirees is higher as a result of Act 189's increase in state retirement benefits. *Davis*, though, prohibits only discriminatory taxation; it does not prohibit differences in take-home income between state and federal retirees.

Third, that the South Carolina Supreme Court has properly applied *Davis*'s holding is additionally and indisputably confirmed by the fact that Petitioners would have been in no different position had state retirees not received a retirement benefits increase. As discussed earlier, *Davis* held states could cure the infirmity of discriminatory taxation "either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees." *Davis*, 489 U.S. at 818. Petitioners impliedly concede that had South Carolina just eliminated the tax exemption for retired state and local government employees, the State's actions would not have violated 4 U.S.C. § 111. (*See* Petition for a Writ of Certiorari, pp. 6-7). Petitioners' problem with Act 189 is that they believe South Carolina took "a third approach not warranted by *Davis*," by repealing the tax exemption for state retirement benefits, but simultaneously increasing the benefits for state retirees by 7%. (*See* Brief of Appellants [Petitioners], p. 8). In other words, under Petitioners' view, had Act 189 just eliminated state retirees' tax exemption, but not taken the additional step of raising state retirees' benefits, Act 189 would have been consistent with 4 U.S.C. § 111. *The problem with Petitioners' position is that there is absolutely no difference in Petitioners' state taxes under the "constitutional" version of Act 189 they argue South Carolina should have adopted as opposed to the purportedly "unconstitutional" version of Act 189 South Carolina actually enacted.* Petitioners would

not have paid a penny less in state taxes had South Carolina simply eliminated state retirees' tax exemption without also increasing their retirement benefits. Petitioners argue that the Court should look to the "practical impact" of Act 189. The practical impact of Act 189 is unmistakable: Petitioners are subject to the same taxation as state retirees, and Petitioners are paying exactly the same amount of taxes they would have paid had Act 189 not included a retirement benefits increase for state retirees.

Fourth, that the South Carolina Supreme Court's decision comports with *Davis* is also buttressed by the fact that *Davis* envisioned and impliedly approved the possibility of a state increasing the compensation of its employees or retirees to make up for assessed taxes. In arguing that Michigan's exemption of taxation of state retirees should be upheld, the dissent in *Davis* maintained that it was "peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." *Davis*, 489 U.S. at 824 (Stevens, J., dissenting). The *Davis* majority, in responding to the dissent, did not dispute *whether* a state may through increased compensation make up for assessed taxes, but *how* a state may do so. The majority implicitly recognized that states may increase salaries or benefits of their employees as long as they do not do so "at the expense of the federal treasury":

> We also take issue with the dissent's assertion that "it is peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." In order to provide the same after-tax benefits to all

> retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

Davis, 489 U.S. at 815 n.4 (internal citation omitted).

Thus, this Court made clear that "the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar" is that which "reduce[s] the State's employment costs at the expense of the federal treasury. . . . " *Id.*[7] By granting a tax exemption rather than increasing the salaries or benefits of state employees, a state may, in effect, be cheating the federal government. To the contrary, South Carolina's Act 189 is not "the type of discriminatory legislation that the

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[7] *See Ward*, 590 S.E.2d at 33 ("The Supreme Court implicitly recognized [in *Davis*] that a state's response to the Court's decision could be to increase compensation to state retirees to offset what those retirees lost in benefits as a result of being taxed."); *Almeter*, 2000 WL 1687589 at *2 ("In *Davis*, both the majority and minority opinions recognized that a state's response to the Court's holding might be exactly what plaintiffs now claim was the response of Virginia's General Assembly; that is, to pay extra money to state retirees to make up for what those retirees lost as a result of being taxed.").

doctrine of intergovernmental tax immunity is intended to bar" because it does not "reduce the State's employment costs at the expense of the federal treasury." *Id.* Rather, South Carolina has voluntarily *increased* its employment costs, while at the same time *bolstering* the federal treasury. Act 189 results in state retirees having to pay more federal income tax because they have to pay such tax on higher income levels (as a result of the 7% increase in state retirement income). As the South Carolina Supreme Court recognized: "The General Assembly's increase in retirement actually increased the employment costs for South Carolina, while simultaneously bolstering the federal treasury." *See Ward*, 590 S.E.2d at 33. Accordingly, Act 189 is consistent with the guidance in *Davis*.

Finally, even if Petitioners' "tax rebate" theory – that South Carolina has simply recast the tax as a benefit increase for state retirees – were legally viable under *Davis*, it would fail factually in this case. The South Carolina Supreme Court made the explicit factual determination that there was not a direct correlation between the increase in retirement benefits and the state retirees' new state tax obligations:

> [W]e find no direct correlation between state retirees' state tax obligations and the amount of increased retirement benefits. All eligible state retirees receive the 7% increase in retirement benefits. Act 189 resulted in an increase in compensation for state retirees, and was not a dollar for dollar offset.

Ward, 590 S.E.2d at 33. There was no direct correlation between the retirement benefits increase and state retirees' new tax obligations because Act 189 conferred a 7% retirement benefits increase to all South Carolina retirees

regardless of the individual retiree's tax liability. The tax liability of many state retirees was zero, while that of many others was between zero and 7%. *See* S.C. Code Ann. § 12-6-510 & 12-6-1170 (Supp. 2003). For example, a state retiree who had previously earned $2,000 in retirement income annually would, after the enactment of Act 189, receive a 7% increase in benefits (for a total benefits amount of $2,140), yet the retiree would not pay *any* additional taxes. Thus, the South Carolina Supreme Court's finding – that there is no direct correlation between the increase in benefits and the increase in taxation – is well-supported by the record. This Court should defer to the state court's factual findings. *See Hernandez v. New York*, 500 U.S. 352, 366 (1991) (plurality opinion) (Court defers to state court findings of fact absent "exceptional circumstances"); 22 James Wm. Moore, *Moore's Federal Practice* § 406.05[4] (3d ed. 2002) ("An issue does not become any less factual simply because its 'resolution is dispositive of the ultimate constitutional question.'") (quoting *Hernandez*, 500 U.S. at 366).[8] In light of the state supreme court's factual determination, Petitioners' "tax rebate" theory cannot succeed, and certiorari should be denied.

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[8] While Petitioners acknowledge that the South Carolina Supreme Court made a factual finding in this regard, they nevertheless attempt to dispute it. (*See* Petition for a Writ of Certiorari, p. 17) ("[A]lthough the court found that the benefit increase did not provide dollar-for-dollar compensation for the increased tax burden, the record demonstrated that the correlation was very high."). Petitioners have not offered compelling reasons for this Court to ignore the state court's findings. *See* Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings. . . .").

Thus, the foregoing reasons demonstrate that the South Carolina Supreme Court's decision in this case is fully consistent with 4 U.S.C. § 111 and *Davis*.[9]

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[9] Unable to offer any persuasive arguments based on *Davis* or any other decision of this Court discussing the intergovernmental tax immunity doctrine, Petitioners resort to reliance on a Commerce Clause case, *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994). While there may be broad conceptual similarities between intergovernmental tax immunity and Commerce Clause cases, at the level of application, *West Lynn Creamery* is of no assistance here. As an initial matter, *West Lynn Creamery* recognized that the Commerce Clause "vests Congress with ample power to enact legislation providing for the regulation of prices paid to farmers for their products" and that the Commerce Clause "limits the power of the Commonwealth of Massachusetts to adopt regulations that discriminate against interstate commerce." *Id.* at 192. By contrast, because of the Tenth Amendment, there is not an analogous limitation on the power of the states to set the compensation of their employees or retirees. Additionally, *West Lynn Creamery* is factually distinguishable because in that case, a Massachusetts pricing order imposed an assessment on all fluid milk sold by dealers to Massachusetts retailers, and the "entire assessment" was "distributed to Massachusetts dairy farmers." *Id.* at 188. Here, there has been no allegation, much less a showing, that the "entire assessment" of state income taxes of federal retirees has been distributed to state retirees. Further, in *West Lynn Creamery*, "[e]ach Massachusetts producer receive[d] a share of the total fund equal to his proportionate contribution to the State's total production of raw milk." *Id.* at 191. Unlike the Massachusetts producers in *West Lynn Creamery*, South Carolina state retirees have not received under Act 189 increased retirement benefits proportionate to their tax contributions; rather, all state retirees have received a 7% retirement benefits increase, regardless of their tax liability. Finally, unlike the out-of-state producers in *West Lynn Creamery* who did not receive the benefits of assessments paid, in this case, Petitioners receive the benefits of the income taxes they pay to South Carolina: Petitioners live (or have lived) in South Carolina and benefit from the state's governmental services and facilities. In sum, *West Lynn Creamery* is easily distinguishable and of no assistance to Petitioners.

II. NO TRUE CONFLICT EXISTS AMONG STATE COURTS CONSIDERING LEGISLATIVE RESPONSES TO *DAVIS V. MICHIGAN*.

Petitioners argue that the Court should grant the petition for writ of certiorari to address "the conflict among state courts created by state legislatures' attempts to overhaul state taxation provisions that are unconstitutional under this Court's decision in *Davis*." More particularly, Petitioners assert that "two state supreme courts [in *Sheehy v. Public Employees Retirement Division*, 864 P.2d 762 (Mont. 1993) and *Vogl v. Department of Revenue*, 960 P.2d 373 (Or. 1998)] have struck down state laws that repeal a discriminatory tax exemption for state retirement benefits while simultaneously increasing the benefits paid to state retirees," whereas two other cases (the current one and *Almeter*) have found that "there is no constitutional problem under *Davis* and the intergovernmental tax immunity doctrine. . . . " (Petition for a Writ of Certiorari, pp. 10, 16). "There is," Petitioners urge, "a square and fundamental conflict between *Ward* and *Almeter*, on the one hand, and *Sheehy* and *Vogl*, on the other." (*Id.*, p. 16). Unfortunately for Petitioners, their argument is rebutted by review of the cases they claim are in conflict.

An analysis of the relevant decisions makes manifest that there is not a true conflict among them. Any differences between these decisions is attributable to the significantly different legislative schemes they address. Cases like the current one – wherein states have increased the benefits of all of their state retirees regardless of domicile and have not mathematically correlated the amount of the increase to the reduction in state taxes – have held that the intergovernmental tax immunity doctrine is not violated. *Ward*, 590 S.E.2d 30; *Ragsdale*,

895 P.2d 1348; *Almeter*, 2000 WL 1687589. By contrast, the cases that have found violations of 4 U.S.C. § 111 have been those wherein states have increased only the benefits of in-state state retirees or have mathematically correlated the increase in benefits to the particular retiree's increase in taxes. *Sheehy*, 864 P.2d 762; *Vogl*, 960 P.2d 373. As explained in greater detail below, the first category of cases is obviously factually distinguishable from the latter.

In *Ragsdale*, the Oregon Supreme Court considered whether the Oregon legislature's response to *Davis* violated the intergovernmental tax immunity doctrine. After the *Davis* decision was issued, the Oregon legislature repealed the tax exemption that it had previously granted on state retirement benefits. The legislature also increased state retirement benefits based on an employee's years of service, but "there [was] no mathematical correlation between taxes and the benefits created. . . . " *Ragsdale*, 895 P.2d at 1350. Further, "every state retiree who qualifie[d] for benefits (based on years of service) . . . receive[d] the benefits, regardless of the state retiree's residency." *Id.* at 1356. Considering this legislative scheme, the Oregon Supreme Court ruled that the legislation did not violate the intergovernmental tax immunity doctrine and upheld the position that "*Davis* does not hold, or even intimate that a state is prohibited from adjusting the compensation of its employees, either currently or retired, to make up for the loss of the [income tax] exemption." *Id.* Among the bases for the Oregon Supreme Court's decision was that there was "no correlation . . . between state retirees' state tax obligations and the amount of increased [state] retirement benefits." *Id.* at 1354. Like the statute in *Ragsdale*, there is no correlation under South Carolina's Act 189

between the state retirees' state tax obligations and the amount of increased retirement benefits.

Similarly, in *Almeter*, 2000 WL 1687589, federal retirees sought a declaration that a 3% increase in retirement benefits for Virginia state retirees was violative of the intergovernmental tax immunity doctrine inasmuch as the increase amounted to a "Tax Rebate" that gave "state retirees the same benefits they had before *Davis*." *Id.* at *1. The *Almeter* court rejected the federal retirees' claims, finding that the Virginia legislation was consistent with *Davis*, which "took no issue with a state's ability to lawfully increase the benefits paid to state retirees to offset the effect of the Court's holding. . . . " *Id.* at *2. South Carolina's Act 189, like the legislative scheme upheld in *Almeter*, also enacted a flat percentage retirement benefits increase for all state retirees.

Petitioners assert that *Ward*, *Ragsdale*, and *Almeter* are in conflict with *Vogl* and *Sheehy*. While *Vogl* and *Sheehy* found the statutes under review to violate the intergovernmental tax immunity doctrine, these cases do not present a true conflict because they considered very different legislative schemes. In *Vogl*, the same court that had decided *Ragsdale* three years earlier considered the constitutionality of a 1995 statute that increased retirement benefits to compensate for damages suffered by state retirees as a result of their benefits being subject to state personal income taxes. *Vogl* held that the 1995 statute violated the intergovernmental tax immunity doctrine; however, in reaching this conclusion, the Oregon Supreme Court expressly preserved its prior holding and analysis in *Ragsdale*: "We emphasize that our holding necessarily is confined to the 1995 statute. We do not overrule *Ragsdale*

or its analysis of the 1991 law." *Vogl*, 960 P.2d at 383. The *Vogl* court found that

> unlike the flat percentages employed by the 1991 statute [*i.e.*, the statute considered in *Ragsdale*], the 1995 statute increases benefits by way of a formula that is fairly closely matched to the task of replacing [state retirement] income that will be lost to taxes.

Vogl, 960 P.2d at 379. Moreover, the 1995 statute itself expressly announced that the increase was not merely a retirement benefit, but was compensation for damages:

> [T]he 1995 statute expressly announces that the increase is paid "in compensation for damages suffered by members of [Public Employees Retirement System] . . . by reason of subjecting [PERS] benefits . . . to Oregon personal income taxation" and is intended as "full, complete and final payment of any claim of a member of the system . . . arising out of the taxation of those benefits."

Vogl, 960 P.2d at 380 (quoting the 1995 statute). Thus, the statute under challenge in *Vogl* is clearly distinguishable from that reviewed in *Ragsdale* and the statute that is the subject of the current case. Unlike the 1995 statute in dispute in *Vogl*, South Carolina's Act 189 did not directly tie the increase in retirement benefits to the additional taxes state retirees had to pay; rather, Act 189 imposed a flat 7% increase for all state retirees, regardless of their new tax liability, and even provided the 7% increase to state retirees who had little or zero tax liability. Additionally, there was no legislative intent expressed in Act 189 to the effect that the increase in benefits was compensation

for damages. Therefore, *Vogl* cannot properly be compared to this case.

Petitioners also erroneously contend that the current case is in conflict with the Montana Supreme Court's decision in *Sheehy*, 864 P.2d 762. *Sheehy* involved a statute markedly different than South Carolina's Act 189. The statute in *Sheehy* granted to "state retirees who [were] Montana residents, and who . . . were to be taxed in response to *Davis*, an annual retirement adjustment payment." *Sheehy*, 864 P.2d at 764. The Montana court found the adjustment to violate *Davis* because it was "provided not to all state retirees, but only to state retirees who are Montana residents." *Id.* at 769. "It is clear that the adjustment is not an actual and legitimate pension or retirement benefit. If it were a pension benefit, the State would have provided it to *all* of its retirees in recognition of their years of public service rather than just those living in Montana." *Id.* at 768 (emphasis in original). By contrast, South Carolina's increase in retirement benefits is not limited to state retirees living in South Carolina, but applies to all South Carolina retirees, regardless of their domicile. Moreover, South Carolina granted the retirement benefits increase not just to those who "were to be taxed in response to *Davis*," *see Sheehy*, 864 P.2d at 764, but even those who were not going to be taxed in response to *Davis*. As such, *Sheehy*, like *Vogl*, is easily distinguishable from the current case, and no true conflict between the states has been identified by Petitioners.

III. THE NATIONAL SIGNIFICANCE OF THE CURRENT CASE IS LIMITED.

Petitioners assert that this case is worthy of the Court's attention because it presents "an important and recurring question of federal law with respect to the intergovernmental tax immunity doctrine. . . . " Petitioners overstate the significance of the case as a decision by this Court would directly affect, at most, only two other jurisdictions throughout the country.

As Petitioners have noted, only some seven states are in the category of those that, in response to *Davis*, eliminated a tax exemption for state retirement benefits and increased the retirement benefits of state retirees. (*See* Petition for a Writ of Certiorari, p. 7 & n.4).[10] Of these seven states, judicial resolution has already and finally been reached in four of them – Oregon (*Ragsdale & Vogl*), Virginia (*Almeter*), Montana (*Sheehy*), and South Carolina (*Ward*) – and a settlement has been reached in the challenge brought in North Carolina. A ruling by this Court would thus potentially have precedential value for only two remaining cases. Therefore, the future impact of the current case is too attenuated to warrant this Court's consideration.

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[10] Twenty seven states were not affected by *Davis* because they did not tax federal and state retirees differently. Of the twenty three states that were impacted by *Davis*, approximately a dozen granted tax exemptions to federal retirees like state retirees. (Petition for a Writ of Certiorari, p. 6 n.2). Moreover, a few other states withdrew the tax exemption from state retirees. (*Id.*, pp. 6-7 n.3). Finally, approximately seven states taxed federal and state retirees and also increased the retirement benefits of state retirees. (*Id.*, p. 7 & n.4).

CONCLUSION

For all the foregoing reasons, the State of South Carolina respectfully requests that the Court deny the petition for writ of certiorari.

Respectfully submitted,

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